

(8)
No. 84-261

White-Supreme Court, U.S.
FILED

JAN 22 1985

ALEXANDER L. STEVAS,
CLERK

**In The
Supreme Court of the United States**
October Term, 1984

COMMODITY FUTURES TRADING COMMISSION,

Petitioner,

v.

GARY WEINTRAUB, et al.,

Respondents.

**BRIEF OF RESPONDENTS FRANK H. MCGHEE
AND ANDREW MCGHEE**

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QUESTIONS PRESENTED

1. Whether a trustee in bankruptcy has the power to assert or waive the bankrupt's attorney-client privilege, with respect to privileged communications antedating the filing of the bankruptcy petition?

2. If so as a general matter, whether a trustee of a corporation in bankruptcy may waive the corporation's attorney-client privilege, with respect to privileged pre-bankruptcy communications, despite the opposition of a stockholder and of the sole director?

3. If so as a general matter, whether a trustee in bankruptcy may, consistent with his fiduciary obligations, waive his debtor's attorney-client privilege, with respect to all pre-bankruptcy communications: (i) for the purpose of facilitating a government investigation, (ii) where the government is adverse to the bankrupt and is empowered to seek sanctions, including financial penalties, against the bankrupt, and (iii) blindly, without consideration of the potential impact of disclosure on the estate (because, *inter alia*, the trustee is unaware of the contents of the privileged communications to the bankrupt's former attorney which are sought to be disclosed)?

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STATEMENT OF THE CASE

This subpoena enforcement action was brought by the Commodity Futures Trading Commission (the "CFTC") to compel Gary A. Weintraub, an attorney, to answer twenty-three questions to which he had asserted the attorney-client privilege of his former client and Canon 4, Rule 4-101, of the Illinois Code of Professional Responsibility (79 Ill.2d XXV, XLIV-XLV (1980)).

In response to the subpoena, Mr. Weintraub had testified on three days (February 26 and 27, and August 26, 1981). He answered approximately 800 questions. After his testimony in the CFTC investigation of his former client, Chicago Discount Commodity Brokers, Inc. ("CDCB"), the CFTC brought this action to compel Weintraub to disclose the privileged matters.¹ Then as now, CDCB was in bankruptcy.

On March 5, 1982, six months after Mr. Weintraub's last examination, and two months after this enforcement action was filed, the CFTC requested CDCB's interim bankruptcy trustee, John K. Notz, Jr.,² to waive CDCB's attorney-client privilege:

¹ The CFTC subpoena also sought production of documents, which were produced by Mr. Weintraub without assertion of any privilege. Accordingly, this case involves no issue concerning documents.

² On the CFTC's recommendation, Mr. Notz had been appointed as equity receiver of CDCB. (J.A., 18-21.) Mr. Notz then filed a voluntary petition in bankruptcy (Chapter 7) on behalf of CDCB, and was appointed interim trustee and eventually permanent trustee for CDCB by the bankruptcy court. The bankruptcy court also approved independent counsel for CDCB as debtor (J.A., 23) and struck the appearance of the trustee's counsel as attorney for the debtor corporation itself (J.A., 24).

[W]e . . . ask you as interim trustee to waive the attorney-client privilege on behalf of CDCB. We [i.e., the CFTC] deem such a waiver to be in the best interests of the creditors of CDCB as well as the corporate debtor.

J.A., 47-48

On March 11, the trustee responded to the CFTC:

As Interim Trustee [for CDCB] I hereby waive any interest I have in the attorney-client privilege possessed by that debtor for any communications or information occurring or arising on or before October 27, 1980.

J.A., 49

Beyond the trustee's letter (granting an unlimited, unconditional waiver without explanation), the record is silent as to any reasons or "considerations" by the trustee. Despite the trustee's after-the-fact effort dehors the record to justify his blanket waiver, the only reason was the CFTC request.³

³ Neither at the time of the "waiver", nor in the bankruptcy court, nor in the district court, was any showing made of any reason for the waiver, or that the trustee gave any consideration to the potential effects of the solicited disclosures. On rehearing in the Court of Appeals, the trustee first claimed (without even a supporting affidavit (see *United States v. Anderson*, 481 F.2d 685, 702 n19 (4th Cir. 1973)) that he had "decided that the best interests of the CDCB estate would be advanced by waiving the privilege" (Trustee's Amicus Br. on Rehearing, 7th Cir., 1). In this Court, the trustee does not say that he determined the waiver would be in the estate's interest. He says instead that the waiver was (in retrospect) in the estate's best interest, based on his opinion that the waiver "assist[ed] the investigation . . . of CDCB [operations]" and "conserv[ed] the [estate's] resources." (*Id.*, at 4.) However, the trustee was not privy to the investigation which he "assisted" (Pet. Br., at 6, n3), and the waiver has not resulted in disclosures of privileged matters from Mr. Weintraub.

(Continued on following page)

This enforcement action was argued to a magistrate (Carl B. Sussman), who held (i) the disputed matters were privileged, and (ii) Mr. Weintraub had properly asserted the attorney-client privilege, but (iii) nonetheless directed Weintraub to answer the disputed questions on the basis of the trustee's subsequent "waiver." Mr. Weintraub filed objections in the district court (R. 27). The CFTC did not appeal from the magistrate's holdings that the privilege applied and had been properly asserted.

Respondents, Frank H. McGhee, the sole officer and director of the corporation, and Andrew McGhee, a stockholder of the corporation (722 F.2d at 339; *See* Pet. App., 14a), were granted leave to intervene by the district court (J.A., 50-51), and also opposed the magistrate's order.⁴

(Continued from previous page)

Respondents have pointed out that the trustee's waiver was given without knowledge of the attorney-client communications involved (Res. Br. Opp. Cert., 3 n.). The Government and the trustee have never disputed this. The trustee could not have determined whether disclosure was in the estate's best interests.

Moreover, the trustee's "waiver" blanketed all pre-petition confidences. The trustee was clearly in no position to know what exposure might result to the corporation from disclosure of privileged matters since CDCB's founding. (Mr. Notz was careful, however, to exclude any waiver of his own attorney-client privilege as trustee. J.A. 49.)

⁴ The Government's suggestion that Respondents failed to preserve their right to challenge the trustee's "waiver" of CDCB's privilege (Pet. Br., 6 n10) is wrong (and apparently overlooks the fact that Respondents first intervened in this proceeding in the district court). In their pleading following their intervention, Respondents noted their position:

Intervenors have asserted, and continue to assert, to the fullest extent of their authority, all attorney-client privileges and all Rule 4-101 privileges belonging to CDCB. They have so advised Respondent, as well as other attorneys who represented CDCB.

R. 49, at 6

The district court (Nicholas J. Bua, J.) affirmed, but later clarified that "Respondent [Weintraub] shall respond to the . . . questions . . . without asserting an attorney-client privilege *on behalf of [CDCB]*" (Pet. App., 17a, 17b) (emph. added).⁵

Respondents McGhee appealed the district court's orders to the Seventh Circuit (R. 54). Mr. Weintraub did not appeal. The CFTC did not cross-appeal as to the application of the privilege or its assertion.

The Seventh Circuit reversed, holding that the trustee could not waive his debtor's privilege under the circumstances presented. The CFTC, joined by several *amici* including the trustee, petitioned the Court of Appeals for rehearing and for rehearing *en banc*. The Seventh Circuit modified its original opinion, principally in response to the parties' additions to the record which that court allowed, but the panel adhered to its conclusion and judgment. Rehearing and rehearing *en banc* were denied: no judge of the Seventh Circuit requested a vote (Pet. App. 21a-22a.)

This Court granted certiorari on October 29, 1984 (J.A. 54).

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⁵ The magistrate had ordered Weintraub to "respond to the various questions . . . [of the CFTC] without asserting an attorney-client privilege" (Order of April 26, 1982; R. 25) (emphasis added).

SUMMARY OF ARGUMENT

The bankruptcy laws neither grant nor support the proposed power of bankruptcy trustees to waive their debtors' attorney-client privilege. Trustee waivers are contrary to the congressional pronouncements on privilege and historical understanding of the applicability of privileges in bankruptcy, even as against trustees themselves. Trustee "waivers" were never contemplated by Congress.

The Government's "management" theory, adopted by only one district judge, is a spurious effort to rationalize the inference of a power which Congress has never granted (or considered) into the complex of specific trustee powers which it has. This approach is inconsistent with the Bankruptcy Code, and ultimately just a variation of the "property" theory (evidentiary privileges are debtors' property), which the Government itself largely abandons. Like the "property" theory (followed by most of the courts allowing trustee waivers), the "management" theory does not apply selectively to corporations, thus allowing trustee "waivers" of individual debtors' privileges, as lower courts indeed have done.

The Government relies on the identity of bankruptcy trustees with their bankrupts, which is untrue both legally and practically. Bankruptcy trustees are elected by the debtor's creditors, or picked by governmental authorities, as here. Their duties and loyalties, like their objectives and goals, are fundamentally different than those of the debtor (the stockholders in corporate bankruptcies), with whom trustees are often in direct conflict. Bankruptcy trustees, as agents of the creditors, make different decisions than corporate management, the agent of the owners

—and the sole party available in bankruptcy to represent the interests of corporate ownership.

The only justification offered for the extraordinary power to compel attorneys to divulge privileged confidences to government authorities (as here) or to creditors (as results) is the discovery of suspected insider fraud—a justification that applies equally in individual bankruptcies.

Existing exceptions to the attorney-client privilege, together with the availability of numerous alternative sources of unprivileged information (sources other than the attorney) refute the claimed “need” for trustees themselves to invade the privilege, just as does the historical absence of such authority until the recent contrivance of the “waiver” theory. The “need” to discover fraud provides no justification for trustee “waivers” in any event.

The proposed waiver authority is also unlikely to uncover much fraud because corporate counsel is unlikely to have the evidence sought, particularly if the waiver power is granted by this Court. The retroactive waiver rule sought here will have no impact on corporate insiders’ privilege as to their personal lawyers. The more pervasive impact would be to chill the willingness of corporate personnel to confide in corporate counsel, and to prevent and inhibit honest management from utilizing counsel for the purposes that the privilege seeks to promote—especially when insolvency looms.

The proposed waiver power would discriminate against insolvent debtors, and would create unjustified, irrational consequences of bankruptcy that would merely be compounded if the Court were somehow to arrive at a

selective adoption of the trustee waiver authority, either to corporations alone or to non-natural “persons”.

Absent express congressional authority, the bankruptcy system should not be used to vitiate privilege.

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ARGUMENT

Introduction: The Nature of the Issue

The Government formulates the issue in this case solely in terms of bankruptcy trustees’ waivers of corporate debtors’ attorney-client privilege, although this issue necessarily implicates the same waiver power as to non-corporate debtors (*e.g.*, individuals, partnerships). Moreover, should the Court somehow find such waiver power implied in the Bankruptcy Code, this issue fairly includes the subordinate questions, both substantive and procedural, of how this extraordinary power may be exercised by trustees in light of their conflicting fiduciary obligations, the constraints imposed by the bankruptcy statutes, and the supervision of the bankruptcy court and the Attorney General to which they are subject.⁶ (Rule 21.1(a)).

⁶ In eighteen judicial districts (including the Northern District of Illinois) United States Trustees exercise supervisory powers over private trustees such as Trustee Notz in this bankruptcy (28 U.S.C. 586(a) (1) and (3)) and also serve as bankruptcy trustee when no private trustee is available (11 U.S.C. 15701(b)). U.S. Trustees are appointed by and subject to removal by the Attorney General (28 U.S.C. 581(a), (c)), and are “under the general supervision of the Attorney General” (28 U.S.C. 586(c)). The bankruptcy trustees that the Government would allow to waive private debtors’ attorney-client confidences are responsible to the nation’s chief law enforcement officer—which explains their pattern of “voluntary cooperation” with government investigations of their debtors (Pet., 16).

The Government seeks to narrow the Court's focus and to avoid the troublesome consequences of the power it advocates. Similarly, the Government disregards significant aspects of privilege law and of the circumstances in which this case arises, and accordingly presents a distorted view of both the issue generally and the impact of the decision in this case.

The Government's proffered concerns are with insider misconduct, and concomittantly with preventing "prior management" from vetoing bankruptcy trustees' waivers of attorney-client privilege in order to "shield" insiders from disclosure of their fraud. The Government insists that access to attorney-client confidences (from the lawyer) is crucial to trustees' bankruptcy duties and to its own law enforcement functions. (See Point III, *post*, pp. 30-31). This hostility to privilege has nothing to do with the circumstance of bankruptcy (or to the corporate status of the debtor).

The Government would reverse the fundamental policy underlying the privilege: that the encouragement of fully informed legal advice before the fact, to promote compliance with the law, is more beneficial than disclosure of confidential communications after the fact to remedy or prosecute illegal conduct, as the Seventh Circuit observed below,⁷ noting *Upjohn Co. v. United States*, 449 U.S. 383

⁷ "The assumption underlying the privilege is that 'the benefits derived from encouraging communications outweigh the costs of keeping information from other parties.' See Note, Attorney-Client Privilege for Corporate Clients: The Control Group Test, 84 Harv.L.Rev. 424, 425 (1970)." (722 F.2d at 340; Pet. App. 5a.)

(1981); *Trammel v. United States*, 445 U.S. 40 (1980); *Fisher v. United States*, 425 U.S. 391 (1976); *Hunt v. Blackburn*, 128 U.S. 464 (1888). This appeal is an attack on the attorney-client privilege.

The Government's characterization of this case also masks the fact that the objection to the trustee's "waiver" of the corporation's privilege here is not solely by "former management". Respondent Andrew McGhee is a substantial *shareholder* in the bankrupt corporation and represents the interests of the *owners* of the debtor corporation, none of whom have sided with the trustee. Despite its expressed concern with insider fraud, the Government's arguments ignore the rights of the corporation's *owners*.

The emphasis on corporate insiders "shielding" their fraud is a red herring, both in this case and generally. Here, the Respondents McGhee are already financially liable and one has already suffered criminal penalty.⁸

In the general case, the Government presumes insider fraud is a routine attribute of corporate insolvencies (but not apparently of all business bankruptcies). Yet even where inside fraud or other misconduct has occurred, it is simply not true that access to privileged discussions—from the debtor's *attorney*—is necessary to discover it.

⁸ Frank McGhee plead guilty to violating the Commodity Exchange Act (7 U.S.C. § 13(a)) and is serving his sentence (Pet. Br., 6 n11). He has also entered into a settlement agreement providing for a voluntary judgment in an amount approximating the remaining 32% of CDCB customer claims not yet paid. (See, Trustee's Pet. Amicus Br., at 3 n1). A judgment has been entered against Andrew McGhee in the amount of \$145,504.51 (U.S. Bankr. Ct., N.D. Ill., Case No. 80 B 14492; Adversary No. 80 A 2143).

Yet that is the sole justification advanced to support bankruptcy trustee waivers.

The Government's false pleas of necessity and the spectre of "shielding" are belied by the settled law of privilege itself. First, as the Government correctly notes, insiders are not individually protected by the corporation's privilege and may not assert it for their personal benefit (Pet. Br., 11). Similarly, corporate insiders cannot assert a corporate Fifth Amendment privilege, and the corporation itself cannot shield disclosure by invoking that personal privilege. See, *Bellis v. United States*, 417 U.S. 85, 87-91 (1974).

Second, all of the insiders (directors, officers, employees) are subject to interrogation as to the underlying factual information without any shielding effect by attorney-client privilege, which does *not* bar disclosure of the relevant *information* simply because it has been disclosed to an attorney. Disclosure is thus available to the trustee, to the Government, and to creditors. The privilege insulates the confidential communications between attorney and client:

The privilege only protects disclosure of communications; it does not protect disclosure of the underlying facts by those who communicated with the attorney:

"[T]he protection of the privilege extends only to *communications* and not to facts. A fact is one thing and a communication concerning that fact is an entirely different thing. The client cannot be compelled to answer the question 'What did you say or write to the attorney?' but may not refuse to disclose any relevant fact within his knowledge merely because he incorporated a statement of such fact into his communication to his attorney."

Philadelphia v. Westinghouse Electric Corp., 205 F Supp 830, 831 (ED Pa 1692).

See also *Diversified Industries[, Inc. v. Meredith]*, 572 F2d [596], at 611; *State ex rel. Dudek v Circuit Court*, 34 Wis 2d 559, 580, 150 NW2d 387, 399 (1967) ("the courts have noted that a party cannot conceal a fact merely by revealing it to his lawyer").

Upjohn, supra, 449 U.S. at 395-396 (1981)

Third, documents and other "recorded information" of the bankrupt client, whether in the hands of the attorney or anyone else, are subject to disclosure and are not protected by the privilege unless they would be privileged in the hands of the client.⁹ *Fisher v. United States*, 425 U.S. 391 (1976).

Finally, but most importantly, the attorney-client privilege does not shield disclosure of attorney-client conversations relating to the planning or commission of on-going fraud, crimes and ordinary torts. *Clark v. United States*, 289 U.S. 1, 15 (1933); *Fisher v. United States*, 425 U.S. 391, 403 (1976); *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971); McCormick, *Law of Evidence*, Ch. 10, § 99, 200-201 (2d Ed. 1972); Cleary & Graham, *Handbook of Illinois Evidence*, § 505.7(1) (4th Ed. 1984). Hence, no "waiver" or invasion of attorney-client privilege is needed to compel disclosure from attorneys of their prior or contemporaneous knowledge of on-going insider fraud.

⁹ In bankruptcy, of course, the trustee is immediately entitled to receive all relevant "recorded information" directly from the debtor (11 U.S.C. § 521(4)) and from the debtor's attorney and accountant (11 U.S.C. § 542(e)) unless privileged.

In this context, the issue in this case reduces to whether a bankruptcy trustee can force the disclosure of all confidential pre-bankruptcy *discussions* between attorneys and clients to others such as the Government and creditors. This issue is far more acute and considerably broader than the Government suggests, and has little if anything to do with the obtaining, by anyone, of information necessary for the administration of bankruptcy estates or even the discovery of fraud.

In this case, it should be noted that attorney Weintraub cooperated with the Government's investigation to the maximum extent allowed by his ethical obligations. He produced all documents requested by the CFTC. He answered over 800 questions under oath. The Government's entire claim that only he can now provide answers to the disputed 23 questions—which undisputedly require divulging of privileged communications—is thoroughly spurious. As Trustee Notz points out, Respondent Frank McGhee has himself committed to make full disclosure to the trustee (Trustee's Pet. Amicus Br., 3 n1).

I. The Bankruptcy Code and Congressional Intent

The powers of bankruptcy trustees, including any power to waive the debtor's attorney-client privilege, derive from federal bankruptcy law. As the Seventh Circuit concluded below:

Although the [Bankruptcy Reform] Act [of 1978] confers broad powers on the trustee, *nowhere* is the trustee given specific authority either to assert or waive a corporate debtor's attorney-client privilege.

722 F.2d at 342 n8 (*see*, Pet. App. 9a n9) (emph. added)

Despite a comprehensive survey of trustee powers under the Bankruptcy Code (including the provisions of Subchapter IV of Chapter 7 which are specifically applicable to commodity brokers (Pet. Br., 19-21)), no trustee power to waive or control the bankrupt's privilege is to be found. There is none.

The Government asks this Court to engraft such a power onto the Code, notwithstanding the congressional omission. In light of the extensive statutory detail of specific powers granted to trustees by Congress, the claim that this additional but unstated power may be inferred is untenable. The contention that trustees' inability to waive debtors' privileges would be "inconsistent with the scheme established by Congress" (Pet. Br., 27) rings hollow: in almost 200 years of bankruptcy legislation,¹⁰ Congress has not found it necessary to grant such a power. Like the former Acts, the 1978 recodification of the bankruptcy laws makes no mention of evidentiary privileges among the subjects over which trustees gain control. If Congress had ever intended such a dramatic consequence of insolvency, it could have and would have said so in plain language.

The congressional intent to preserve the attorney-client privilege in bankruptcy, and Congress's consistent understanding that debtors' privileges generally apply in bankruptcy, are to the contrary.

With respect to the attorney-client privilege specifically, Congress has *expressly prohibited* bankruptcy trustees from themselves obtaining privileged attorney-client confidences from the debtors' counsel:

¹⁰ E.g., Act of April 4, 1800 (2 Stat.L. 19); Act of August 9, 1841 (5 Stat.L. 440); Act of March 2, 1867 (14 Stat.L. 517); Act of July 1, 1898 (30 Stat.L. 544); Bankruptcy Reform Act of 1978, P.L. 95-598.

(e) *Subject to any applicable privilege*, after notice and a hearing, the court may order an attorney, accountant, or other person that holds recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs, to disclose such recorded information to the trustee.

11 U.S.C. § 542(e) (emph. added)

Three points must be emphasized about § 542(e). First, Congress reiterated the validity of the privilege as against the trustee, which is a step beyond the issue in this case (trustee "waivers" and disclosure of pre-bankruptcy confidences to others, such as creditors and the Government). Second, the statutory restriction would be meaningless (and utterly unnecessary) if the trustee already had the power to waive the very privilege to which § 542(e) makes him "subject". Congress's enactment of § 542(e) is inconsistent with the argument that a general waiver power may be read into the Code.

Third, this statutory restriction protecting the privilege from the trustee is especially significant in light of the purpose of § 542(e): to expand trustees' power to obtain "recorded information" from debtors' attorneys, by "depriving professionals of the leverage they had under State lien provisions" to withhold documents in their possession until they were paid.¹¹ (Comment, 11 U.S.C.S.

¹¹ The Government says that Congress "left the privilege issue" to be decided by the courts," citing floor comments at the time of the final House amendments to the 1978 legislation (Pet. Br., 22 n39). What the statute left to the courts, appropriately, was the case by case determination of what is privileged, i.e., when the privilege is applicable to specific documents. The cited comments, like the remainder of the legislative history, never mentioned or even alluded to trustee "waivers" of debtors' privileges or trustee disclosures of privileged matter to others.

(Continued on following page)

§ 542; see also, House Rept. No. 95-595, 95th Cong., 1st Sess., 396-370 (1977) ("House Report"); Sen. Rept. No. 95-989, 95th Cong., 2d Sess., 84 (1978) ("Senate Report"). The only function of the limitation is to prevent the added trustee power from reaching *privileged* documents.

Section 542(e) is consistent with Congress' historical understanding that common law privileges apply in bankruptcy even as against the trustee—absent statutory provision granting the trustee access to privileged information—which has long been the common view. (See, e.g., 5 Remington, Treatise on the Bankruptcy Law, §2003, 82 (15th Ed. 1953).) In §21(a) of the Bankruptcy Act of 1898, which formerly governed the examination of the debtor and related parties, Congress eliminated the spousal privilege by express proviso. That provision would have been utterly unnecessary if the privilege were not applicable in the first instance, and would be nugatory as against the trustee if the trustee could simply circumvent the privilege by exercising a "waiver".¹²

(Continued from previous page)

To the extent that the cited remarks suggest that the validity of debtors' privileges against their trustees was then unclear, the speakers failed to indicate any basis for that conclusion, which is unsurprising since *no decision* has been found holding that trustees may invade debtors' privileges. The weight of authority is uniformly contrary: *In re O'Donohoe*, 18 Fed. Cas. 587 (Fed.Cas. No. 10,435) (D.Me. 1869); *In re Krueger*, 14 Fed.Cas. 870, (Fed.Cas. No. 7,942), 2 Lowell 182 (D.Mass. 1872); *In re Aspinwall*, 2 Fed.Cas. 64, (Fed.Cas. No. 591), 7 Ben. 433 (S.D.N.Y. 1874); *In re Teuthorn*, 5 Am.Bankr.R. 767 (D.Mass. 1901). Moreover, if the cited remarks were to be interpreted as the Government suggests, then they would be *contrary* to what the legislation itself provided—that attorneys are *not* required to turn over privileged documents.

¹² As the Seventh Circuit put it below: "Such a passage of the privilege could engender the absurd result of the trustee waiving the debtor's privilege as to information sought by the trustee." (722 F.2d at 342; Pet. App. 10a.)

Unlike its treatment of the spousal privilege, Congress has never provided for compulsory disclosure of attorney-client confidences in bankruptcy, to the trustee or anyone else. The laws governing bankruptcy examinations have not been materially changed since 1867, and have never permitted trustees to compel disclosure of information protected by their debtors' pre-petition attorney-client privilege. *In re O'Donohoe*, 18 Fed.Cas. 587 (Fed.Cas.No. 10,435) (D.Me. 1869); *In re Kreuger*, 14 Fed.Cas. 870 (Fed.Cas.No. 7,942), 2 Lowell 182 (D.Mass. 1872); *In re Aspinwall*, 2 Fed.Cas. 64 (Fed.Cas.No. 591), 7 Ben. 433 (S.D.N.Y. 1874); *In re Teuthorn*, 5 Am.Bankr.R. 767, 774-775 (D.Mass. 1901).

Under Section 343 of the Bankruptcy Code (11 U.S.C. §343), as well as under its predecessors (Section 21(a) of the Bankruptcy Act of 1898 and Section 26 of the Bankruptcy Act of 1867), a trustee *cannot* compel disclosure of information covered by the debtor's pre-petition attorney-client privilege, either (i) by examination of the debtor's attorney (*In re Aspinwall, supra*), or (ii) by examination of the debtor:

Undoubtedly, a bankrupt is bound to disclose the whole truth concerning his property, dealings, &c., and to surrender all his books, contracts, &c., to his assignee; equally true is it that every witness, whether a party in interest or not, is bound to disclose the whole truth concerning the matter under inquiry: but the whole truth does not include confidential communications between client and solicitor, or client and counsel, which are admissions made under the seal of authorized secrecy.

In re Krueger, supra, 14 Fed.Cas. at 871

or (iii) by employment of the debtor's counsel or former counsel:

. . . but it seems to me that the time to determine the question as to the right of the bankrupt's former

attorney to conduct the examination in behalf of the trustee is at the beginning . . .; that it should be said at the outset, that to admit him to appear at all in the matter is in effect to remove the protection with which the law surrounds the bankrupt, and to subject the privilege which has been given to the communications which he has made to his counsel to the danger of indirect and insidious assault . . .

In re Teuthorn, 5 Am.Bankr.R. 767, 774-775 (D. Mass. 1901)

Congress' consistent failure to overrule these decisions in all of the succeeding years of bankruptcy legislation is significant. The recently-contrived trustee waiver theory flies in the face of this long-settled, congressionally-accepted principle. Moreover, none of the recent decisions which have allowed trustee waivers of debtors' attorney-client privilege have even considered this body of law.¹³

Trustee waiver power cannot be judicially inferred on the basis of legislative intent or history, which are contrary, rather than supportive or even silent. The Government and the trustee are each barred by settled law from piercing the confidentiality of attorney-client communications; what they seek here is judicial approval to invade the privilege collectively when neither can lawfully do so alone. The result, of course, would be to undermine the privilege and to create a consequence of bankruptcy (voluntary or involuntary) which Congress never contemplated and cannot be held to have permitted by inference.

¹³ See cases cited by the Government (Pet. Br., 24 n41).

II. The "Management" Theory of Trustee Waivers

In the absence of express statutory authority for trustees' control of their debtors' privileges, the Government resorts to the theory that the missing power may be inferred into the aggregation of delegated powers. The Government reasons that if bankruptcy trustees have been given certain of the powers which corporations' elected boards of directors hold, then trustees should have all such powers.

A. The Government's Theory Lacks Support

The Government's "management" theory has been adopted by a single district court in an unpublished opinion. *In re Continental Mortgage Investors*, No. 76-593-S (D.Mass. July 31, 1979) (Chapter X reorganization). That decision has not been followed in the intervening years, even by those courts which have arrived at the same result of permitting trustee waivers.¹⁴

The Seventh Circuit below rejected the management theory (722 F.2d at 342; Pet. App., 8a, 16a), along with

¹⁴ The three Circuits which have approved trustee waivers of their debtors' attorney-client privileges have each based their decisions on other theories: *Citibank, N.A. v. Andros*, 666 F.2d 1192, 1195 (8th Cir. 1981) (the privilege "passes with the property" of the debtor to the trustee); *In re O.P.M. Leasing Services, Inc.*, 670 F.2d 383, 387 (2d Cir. 1982) ("the . . . privilege adheres to the trustee by virtue of the nonexistence of any other entity authorized to so act" under the particular circumstances); *In re Boileau*, 736 F.2d 503, 506 (9th Cir. 1984) (examiner gained "expanded powers" including control of the debtor's privilege under the "distinctive" facts, by virtue of his appointment "by stipulation"). Except for the *Continental Mortgage* opinion, the district court and bankruptcy court decisions which have allowed trustee waivers have either adhered to one or more of these theories or have simply followed the *Citibank* or *O.P.M.* "rule" allowing trustees to waive their debtors' privilege. That is the nature of the "weight of authority" (Pet. Br., 24) favoring trustee waivers; see cases cited at *id.*, 24 n41.)

Continental Mortgage, as well as *Citibank, N.A. v. Andros*, 666 F.2d 1192 (8th Cir. 1982) which relied on *Continental Mortgage* but adopted a *different* theory of trustee waiver power (the "property" theory: that the privilege passes with the debtor's property). The Government's theory does not have significant judicial support.

The "management" theory of inferential powers is also unsupported by the Bankruptcy Code. The Code does not grant a general "management" power to trustees over the affairs and rights of debtors (even in Chapter 7).

What Congress has done in creating bankruptcy trusteeships and in prescribing their relationships and powers bears review. The Code makes the trustee "the *representative* of the *estate*" of the debtor (11 U.S.C. §323(a)). (It does not make the trustee the representative of the debtor itself, nor has Congress merged debtors—even corporate debtors—into their bankruptcy trusteeships.¹⁵) The Code, in turn, defines the estate to be "comprised of all the following property . . ." (11 U.S.C. §541). The extensive enumeration of specific powers that the Code then grants to trustees all pertain to the "estate" and thus the

¹⁵ As the Seventh Circuit observed (722 F.2d at 342; Pet. App. 9a):

. . . the trustee . . . does not replace the corporation as an entity. *** Nor does the trustee succeed to the positions of the officers and directors of the corporation. [15 A.W. Fletcher, *Private Corporations* §7657 (Rev.Ed.1981)] In brief, the corporation will continue to exist, until formally dissolved by action of its shareholders or by the state [of incorporation].

Despite its attack on the Seventh Circuit's corporate law conclusions, and its claim that the court ignored Bankruptcy Code provisions that "completely divest former management of any control over the firm's operations" (Pet. Br., 18 n28) (emph. added), the Government fails to find any authority for the proposition that elected corporate officers cannot continue to represent ownership during bankruptcy.

property of the bankrupt. The statutory nature of trustees is thus quite different than the universal management role (or alter ego) in which the Government would cast them.

Unless the Court were to hold that evidentiary privileges are "property" of debtors, and thus part of the estate, it is difficult to see how bankruptcy trustees can come to control such rights. The Government understandably relegates the "property" theory of trustee waiver power to an alternative position, gently suggesting in one footnote that the privilege might be viewed as an "intangible asset that passes to the trustee" (Pet. Br., 22 n38). It cannot. Like civil and constitutional rights, evidentiary privileges are simply not property rights.¹⁶

¹⁶ Evidentiary privileges, unlike property, are procedural rights which arise purely as matters of law, and are not assignable, devisable or inheritable, nor subject to creditors' levy (nor currently taxable).

In Illinois, the attorney-client relationship, of which the privilege is an attribute, is unassignable. *Clement v. Prestwich*, 14 Ill.App.3d 479, 448 N.E.2d 1039 (2d Dist. 1983). It does not pass to a trustee in bankruptcy, who may not assert his debtor's interests as a client against his former attorney. *Christison v. Jones*, 83 Ill.App. 3d 334, 405 N.E.2d 8, 11-12 (3d Dist. 1980):

... the personal nature of the [attorney-client] relationship and the duty imposed on the attorney, coupled with the public policy considerations surrounding that relationship and any breaches thereof ... lead us to conclude that the legal malpractice claim is not subject to assignment.

... the decision as to whether a malpractice action should be instituted should be a decision peculiarly for the client to make. To allow that decision to be made by an assignee or by a trustee in bankruptcy, without any regard to the client's wishes or intentions (or completely contrary to the client's wishes) would be to encourage the untoward consequences set forth in [*Goodley v. Wank & Wank, Inc.*, 62 Cal.App. 3d 392, 133 Cal. 83 (1976)] ... We conclude that a cause of action for legal malpractice ... is not part of the estate of the bankrupt ...

It should be noted that if privileges were treated as "property", bankruptcy trustees would require court approval to dispose of them (e.g., by waiver), under 11 U.S.C. § 363(b).

Even if the various Code trustee powers may be generically characterized as management-type powers, the only "management" which the trustee is authorized to exercise is over the *estate* (which is property) and *not* over the debtor itself or the debtor's non-property rights. The Bankruptcy Code simply provides no basis for expanding the powers which have been granted to trustees with respect to their debtors' estates to reach a power which has not been granted over rights which are not part of the estate.¹⁷

B. Bankruptcy Trustees are Different Than Corporate Management Outside of Bankruptcy

Despite the fact that bankruptcy law does not make bankruptcy trustees the alter ego of their debtors, nor designate them as successors of corporate directors, nor vest in them any blanket power to exercise *all* of the authority vested in those positions, the Government argues that this Court should reach these results by analogy and disregard the basic differences in the roles of owner-elected corporate management and creditor-elected bankruptcy trustees.¹⁸

The most glaring differences between bankruptcy trustees and non-bankruptcy management (of corporations, of partnerships and of individuals) are *whom* they repre-

¹⁷ The Seventh Circuit correctly recognized that the "management" analysis, despite its functional trappings, essentially collapses back into the "property" view of the *Citibank* decision. (722 F.2d at 342; Pet. App. 9a.)

¹⁸ The Government seemingly recognizes that its reasoning is less than perfect. It is constrained to argue that the trustee's fiduciary duties "parallel" (Pet. Br., 16) and "are analogous to" (*id.*, 17) those of pre-bankruptcy management. The Government's view is made clear in its formulation of the issue as "who constitutes the 'management' ... in bankruptcy" (Pet. Br., 22), which simply assumes the issue in this case.

sent, from *whence* they come, and to *whom* they are answerable.

Liquidation trustees come from the creditors, who elect them¹⁹ (11 U.S.C. §702), and whom they represent as a practical matter. Non-bankruptcy management, on the other hand, is chosen by the *owners*. Although the Government argues that the owners (shareholders, in the case of a corporation) are *among* the class of creditors to whom trustees owe a duty (Pet. Br., 17), the owners are (i) at the very bottom of the class (11 U.S.C. §726) and (ii) generally disqualified from voting in the trustee's election (11 U.S.C. §§702, 726(a)(6)).

In any event, corporate "management" owes its sole fiduciary duty to ownership—bankruptcy trustees at best owe a residual portion of their collective duty to owners. This distinction cannot be papered over by legal rhetoric: the trustee will often act and decide matters differently than management because he is guided by different goals, loyalties, and responsibilities. Corporate management does not, like the trustee, have fiduciary obligations to general creditors.²⁰

As courts have observed, it is not at all uncommon for the trustee's duties and collective responsibilities—not to

¹⁹ Except when they come from the Government, e.g., through the United States Trustee's office. (11 U.S.C. 15701.) (See *ante*, p. 7 n6.) In the 18 districts having U.S. Trustees, that federal officer selects *interim* trustees "promptly after the order for relief" in Chapter 7 cases. (*Ibid.*)

²⁰ Corporate officers and management generally do not have fiduciary duties to their company's creditors, although the corporation certainly has *legal* duties to its creditors. The corporation may even have fiduciary obligations to certain of its creditors (e.g., financial customers), but the existence of a fiduciary duty depends upon the legal relationship. The general debtor-creditor relationship is not yet amongst those giving rise to "fiduciary" duties.

mention his loyalty to those who have elected him—to place him in *conflict* with the interests of ownership. Outside of bankruptcy, management never is in conflict with the interests of ownership (or it rapidly ceases to be management).

In *In re O.P.M. Leasing Services*, 670 F.2d 383, 386 n2 (2d Cir. 1982), the court noted the observation in *Ross v. Popper*, 9 B.R. 485, 487 (Magistr. S.D.N.Y. 1980) (aff'd by the district court without separate opinion) that bankruptcy trustees "frequently" side with creditors even when contrary to the bankrupt's interests; and the *O.P.M.* court acknowledged that a trustee's duties can "place him in conflict with the interests of the debtor." The observation in *Popper* was:

In that context [pre-bankruptcy attorney-client communications], it seems to me almost axiomatic that the beneficiary of such communications is the bankrupt corporation itself, whose interests are quite obviously adverse to the interests of the trustee in bankruptcy, representing the general creditors. It therefore seems . . . that the only proper person to decide whether there should be a waiver of attorney-client privilege respecting transactions that took place prior to bankruptcy is the bankrupt corporation itself, by its authorized officer or officers.

Quite recently, in *In re Vantage Petroleum Corp.*, 40 B.R. 34, 40 (Bankr. E.D.N.Y. 1984), a bankruptcy judge concluded:

The bankruptcy cases involved herein clearly demonstrate that the Trustee's relationship to the debtor corporation may be as adversarial as the relationship between the prosecutor and the subject of a criminal investigation. It would be as anomalous to allow the prosecutor to waive the subject's privilege, as it would be to allow the trustee to waive the debtor corporation's privilege.

Vantage Petroleum is especially poignant because it arose in the Second Circuit after *In re O.P.M. Leasing Services, Inc.*, *supra*, which the bankruptcy court reassessed in light of the Seventh Circuit's opinion in this case. *O.P.M.* had relied on the *absence* of any corporate officials in allowing a bankruptcy trustee to waive the corporation's attorney-client privilege; the *Vantage Petroleum* court refused to countenance a waiver by the trustee(s) there, if officers of the corporate debtors were shown to be available to control their corporations' privileges, commenting:

The duties of a trustee in a chapter 11 case are enumerated in 11 U.S.C. §1106. This enumeration can not be construed, through the express language or by implication, to strip the debtor and its directors and officers of all legal rights and responsibilities. The power to waive or assert the attorney-client privilege is not expressly dealt with.

The right to assert an attorney-client privilege as to pre-petition matters should be, perhaps, one legal right of the debtor to remain unscathed after a trustee has been appointed.

• • •

... the policy concerns behind the existence of the attorney-client privilege are as applicable to an entity before it files for bankruptcy as to any other entity. Absent express language in the Bankruptcy Code, the privilege should not be abrogated in the situation where its protections may be needed most.

Another distinction between the roles of non-bankruptcy "management" and bankruptcy trustees is that trustees are officers of the court (*Freeman Coal Mining Corp. v. Burton*, 388 Ill. 604, 58 N.E.2d 589, 593 (1944), *cert. denied*, 325 U.S. 859 (1945)), answerable to the bankruptcy court (see, *Imperial Assurance Co. v. Livingston*, 49 F.2d 745, 748 (8th Cir. 1931)). Moreover, many of the trustee's powers (which the Government here terms "management"

powers) are not actually delegated to the trustee, but are exercisable only with bankruptcy court approval (*e.g.*, 11 U.S.C. §§ 363(b), 364(b), 364(c), 364(d), 365, 721). Non-bankruptcy management is answerable to ownership only, and not to courts for its routine "management" decisions, absent extreme circumstances.

Aside from the differences in accountability and loyalty, non-bankruptcy management and bankruptcy trustees have different goals and objectives. This is especially so in Chapter 7 liquidations, such as is involved here.

The liquidation trustee has a single overriding goal: maximizing the net value of the estate at one point in time and as soon as practicable. House Report, 379 (1977); Senate Report, 93 (1978). Non-bankruptcy management, on the other hand, runs a going business with a long-term view—to income production, preservation and upgrading of capital assets (and their financing), personnel, changing technology and the myriad of related concerns which determine the bottom lines (ongoing income *and* present ownership value). The trustee has other concerns; his goals are inherently short-term, and normally (absent court approval under 11 U.S.C. § 721) liquidating trustees do not operate their debtors' businesses except to wind up its affairs.²¹ And of course, the trustee's perspective towards

²¹ The Government's statement that "in a commodity broker liquidation, the trustee always . . . manage[s] the firm's business" (Pet. Br., 25 n42) is misleading: the trustee does so, but only as necessary to close out open trades, wind up the firm's affairs, and liquidate the assets. In fact, the provisions of the special commodity broker subchapter (IV of Chapter 7) of the 1978 Code were added to facilitate "orderly liquidation"; they reduced the trustee's discretionary powers over the debtor's outstanding contracts and substituted four specific powers aimed at directing commodity broker trustees how to close out open trading positions. (House Report, 272.) That legislation has nothing whatever to do with attorney-client privilege or insider fraud.

creditors is precisely the reverse of non-bankruptcy management's.

The trustee-ownership conflict is often reflected in a basic bankruptcy dispute: whether a Chapter 7 proceeding should be continued or dismissed. (Dismissal is available to corporate debtors and commodity brokers. 11 U.S.C. § 707.) Trustees often oppose debtors on such motions, demonstrating both the adversity of ownership and trustees and the need for (and judicial recognition of) distinct ownership representation in bankruptcy.²² The argument that corporate management has no power and cannot continue to represent the corporate ownership would preclude a corporation from even requesting a dismissal, even if it had settled with its creditors.

The fundamental differences in underlying motivation predictably lead to different decisions by trustees in "managing" their debtor's estates than the debtor would make outside of bankruptcy—whether or not the business is in fact solvent or insolvent. This applies with equal force to decisions respecting "waiver" or disclosure of prior attorney-client confidences. The trustee is simply not the same as, or in the same position as, non-bankruptcy management.

C. The "Management" Theory is Not Uniquely Applicable to Corporations, but Would Sanction Trustee Waivers of All Debtors' Privilege(s), Including Individuals'

The Government's reliance on the "management" approach to support a trustee waiver power appears intended

²² See, e.g., *Re Hall*, 15 B.R. 913, 8 BCD 556, 5 C.B.C.2d 1028 (BAP 9th Cir. 1981); *Re Ross*, 21 B.R. 5 (Bankr. E.D.N.Y. 1982); *Re Pagnotta*, 22 B.R. 521, 9 BCD 600 (Bankr. Md. 1982); *Re Bryant*, 28 B.R. 362 (Bankr. N.D. Ind. 1983); *Re Jackson*, CCH Bankr. Rptr. ¶ 67765 (Bankr. E.D. Tenn. 1980).

to contrive a legal theory susceptible of selective application to corporate debtors—seemingly to avoid the unpalatable result of bankruptcy trustees waiving the privileges of *individuals*. The management theory does not accomplish this goal, just as the Eighth Circuit's "property" approach in *Citibank*, *supra*, has not avoided this result.²³

Nor does the Government contend that its theory preserves individual privilege in bankruptcy: it hedges its position on waiver and disclosure of individuals' attorney-client confidences (Pet. Br., 23 n39)²⁴ on a trustee's "whim" (722 F.2d at 343; Pet. App. 10a) or "judgment as to the best interests of the *estate*" (Pet. Br., 32 n51) (*emph. added*). Claiming incorrectly that individual debtors' privileges are not implicated here, the Government reserves its position to pursue individual privilege in other litigation, even while citing decisions that have permitted trustee waivers of individual and partnership privilege as authority for permitting such waivers of corporate privilege.²⁵

²³ *Citibank, N.A. v. Andros*, 666 F.2d 1192 (8th Cir. 1981), has been applied by lower courts to permit bankruptcy trustees to waive the attorney-client privilege of *individual* debtors, e.g., *In re Smith*, 24 B.R. 3 (Bankr. S.D.Fla. 1982); *In re Grand Jury Proceedings, Grand Jury No. 84-21* (S.D.Cal. June 21, 1984) (unpublished).

²⁴ The Government says that "different considerations arguably may apply" to the question of who may waive an individual's privilege in bankruptcy (Pet. Br., 23 n39), but refuses to take a position on the result, while avoiding identification of such considerations. No analysis is suggested as to how such "considerations" might differ from those advanced against corporations here—or how such considerations might relate to (i) the "management" theory, or (ii) the trustee's statutory powers (on which that theory is based), or (iii) the "property" analysis (with which the management view is inextricably tied).

²⁵ *In re Smith*, 24 B.R. 3 (Bankr. S.D.Fla. 1982) (individual debtor's privilege); *In re Boileau*, 736 F.2d 503 (9th Cir. 1984) (partnership debtor's privilege).

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Under the Bankruptcy Code, there is no way to distinguish between individual and corporate debtors with respect to the disputed power of trustees to waive their debtors' privilege. This is so whether the analysis looks to the powers of trustees, or to the succession of "management," or to the "property" involved. The Code does not differentiate in any of these regards (or in any significant regard whatever) between individual and corporate debtors, nor for that matter does the Code differentiate partnership debtors (as to which the Government is silent).

Individuals, corporations and partnerships are all "persons" under the Code (11 U.S.C. § 101(33)) and are equally eligible to avail themselves (or to be involuntarily availed) of bankruptcy; *see*, 11 U.S.C. §§ 109, 301, 303. Relief under Chapter 7 is equally available to individuals, corporations and partnerships. Thus, liquidation or "straight bankruptcy" is not at all unique to corporations²⁶ (11 U.S.C. § 109). There is no overall distinction in bankruptcy between individual and corporate bankrupts.

Nor is there any distinction between the powers of individual and corporate debtors' trustees in bankruptcy.

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It must be noted that both the Government and Respondents have misread *Boileau, supra*: the debtor was "Paul J. Boileau . . . doing business as Boileau & Johnson" (736 F.2d at 504), a partnership (*id.*, at 506). The *Boileau* court allowed an examiner (based on a stipulation) to waive the partnership's attorney-client privilege, but not an individual's privilege (as Respondents stated in error, Res. Br. Opp. Cert., 11), nor a corporation's privilege (as the Government erroneously contends, Pet. Br., 22 n39).

²⁶ Contrary to the impression cast by the Government, Chapter 13 wage-earner plans are not the sole form of bankruptcy for individual people and sole proprietorships (*see*, Pet. Br., 13 n18).

Trustees have the same powers with respect to the debtor's estate (which is the debtor's "property" for every type of debtor), and have no power over the debtor. None of the "management" powers on which the Government's theory relies apply selectively to corporations or are selectively inapplicable to individuals.²⁷ The "management" powers analysis gives the same powers to trustees to "manage" debtors' estates, whatever those powers may entail, without regard for the status of the debtor.

Moreover, the bankruptcy examination powers, which allow for investigation and discovery of the debtor's affairs by trustees as well as creditors, are noteworthy for their uniformity: they apply across the board to all debtors. (11 U.S.C. § 343; Fed.Bankr.Rule 2004.) Direct testimony by the debtor and any other person having knowledge of the debtor's business or finances is required. Either privilege applies in such examinations or it does not: there is no basis for two separate rules or results.

As the Seventh Circuit found below (722 F.2d at 342):

The debtor has a clear right to assert privileges during this examination. *See In re Blier Cedar Co.*, 10 B.R. 993 (Bkrty.D.Me. 1981). *See also* 2 Collier on Bankruptcy, ¶ 343.12 (5th ed. 1982).

The Government has cited no authority for disputing that conclusion or for imposing a distinction between individual and corporate debtors unfounded in the statute and rule, both of which have been approved by Congress, which plainly did not contemplate or countenance the selective

²⁷ This is also true of the trustee's powers in the special provisions of Subchapters III and IV of Chapter 7, which apply only to stock and commodity brokers (Pet. Br., 19-21). Brokers, moreover, can be individuals.

expansion of this examination power into privileged matters or the same result through the circuitous device of trustee "waivers".

When the analysis shifts in emphasis from the specific Code powers to the general panoply of trustees' "management" authority, there is again no distinction to be found between the trustee's power (or need) to "manage" the estate (property) of corporations and individuals. Whatever the business, finances and property of the debtor may involve, the trustee is in the identical "management" posture irrespective of the form of organization of his bankrupt.

The Government's final effort to carve a distinction between individuals and corporations, relying on the necessity for corporations to act through human agents, is a *non sequitor*. (Pet. Br., 31.) Any principal, corporate or individual or otherwise, can act through agents, and can act through more than one agent. The fact that corporations always do so is no basis for distinguishing individuals who optionally do so. And bankruptcy trustees are not agents of their bankrupts in any event (11 U.S.C. § 323(a)).

III. The Government's Sole Justification

The Government advances one justification for reading a waiver-of-privilege power into bankruptcy trustees' authority over their debtor's estates: insider fraud and misconduct. The proposed waiver power is said to be "a necessary adjunct" (Pet. Br., 15) of trustee "duties" under the Code (*ibid.*; *id.*, at 27) which are "impossible" to fulfill "without access to pre-petition communications with

counsel" (*ibid.*).²⁸ On this reasoning, the Government would permit waivers in favor of itself and creditors, as well as would allow trustees themselves to invade privileged pre-petition communications.

There are three aspects of the insider fraud spectre in the Government's argument: (i) the trustee's discovery of fraud and recovery from insiders (*e.g.*, Pet. Br. 14, 15, 27, 28, 29, 30, 32); (ii) the Government's prosecution of fraud (*id.*, 32-33); and (iii) the "shielding" by insiders of their fraud (*id.*, 27, 28, 36) by "vetoing" a waiver by a "co-operating" trustee (*id.*, 29, 32-33). The "shield" would presumably apply, like the privilege itself, against the entire world (*e.g.*, the Government, creditors, would-be creditors, and the trustee).

Analysis dispels the "need to get at insider fraud" justification, particularly the need to do so by obtaining privileged confidences from debtors' attorneys.

Initially, it is observed that the fraud discovery argument, even if accepted as a matter of policy, does not itself justify "waivers" to others. If this justification has any vitality, it extends no further than to the trustee's own obtaining of privileged communications for the benefit of the debtor's estate.

But if bankruptcy trustees' "need" to obtain privileged confidences were as acute and pervasive as is now

²⁸ This approach presents the anomaly of inferring unstated powers from duties rather than from delegated authority. Such reasoning would go far to justify the expansion of governmental authority over private rights. Respondents submit that the more appropriate view, where established rights are involved, is to adhere to those rights unless they are expressly abrogated, explicitly subordinated to governmental authority, or simply eliminated in the first instance.

urged on this Court, then it is difficult to understand how such necessity arose only in recent years. Prior to *In re Amjoe, Inc.*, 11 Collier Bank. Cas. 2d (MB) 45 (M.D.Fla. 1976), no judicial decisions have been found permitting trustees to gain access to privileged matters by any device (*see e.g.*, cases cited at Pet. Br., 24 n41).

The absence of litigation and scholarly debate on the trustee access and "waiver" issues for so many years (since the 1869-1901 decisions which bar trustee invasion of privilege; *see*, pp. 16-17, *ante*) is virtually inexplicable—unless trustees were able to perform their duties *without* access to their debtor's privileges and unless the accepted legal view was that they had no such access or "waiver" powers. Otherwise someone would surely have litigated the question in that time.

The claim of "impossibility" for trustees' performance of their duties without access to pre-bankruptcy privileged communications is patently spurious. The 1984 rhetoric of "necessity" for abrogating privilege, like the device of bankruptcy trustee "waivers," is of recent manufacture. This newly-perceived "need" is little more than *desire* for an extraordinary power which Congress has not even recognized, much less supplied, although insider fraud is hardly a recent phenomenon.²⁹

Just as the Government's plea of necessity does not hold up historically, so it fails to survive scrutiny on its merits. Debtors' attorneys, as repositories of pre-bank-

²⁹ The "need" to remedy or punish financial fraud by invading attorney-client confidences has not been granted by Congress even when providing enforcement powers to agencies such as the CFTC and the Securities and Exchange Commission. *See*, 7 U.S.C. §§ 1, et seq.; 15 U.S.C. §§ 78a, et seq.

ruptcy confidences with their clients, are not the sole or even likely source of the information which the trustee needs. This is as true in the garden-variety corporate bankruptcy as in the particular circumstances of commodity and stock brokers, and whether or not insider fraud has occurred.

The most critical information is unprivileged and readily available. As reviewed *ante* (Introduction, pp. 10-11), recorded information and financial records of the debtor are available to the trustee, irrespective of who has possession. As in this case, the *debtor's* documents are unlikely to be privileged, particularly financial records, and for corporate debtors no Fifth Amendment rights are involved.

The attorney is also an available source of unprivileged information given to him by his client, including not only documents, but information not part of confidential or advisory discussions. In most cases, however, counsel is unlikely to have significant personal knowledge of the day-to-day transactions sought by trustees.

On the other hand, all of the debtor's employees (and officers and directors) are available to provide such information, and they are not protected against disclosure of the factual information required. And third-parties are reachable for both documents and testimony relating to the debtor's affairs (Fed.Bankr.Rule 2004).

As against all of these sources of information, the additional information available from the *attorney's* recollection and notes of prior confidential discussions with his client and its personnel (*Upjohn v. United States, supra*) is hardly critical to discovery of insider fraud.

Most significantly, the type of attorney-client disclosures which is the heart of what the Government seeks to obtain from attorneys is not protected by the attorney-client privilege in the first place: conversations concerning ongoing fraud, crime and tort. There is accordingly no need to invade or "waive" privilege to get at this unprivileged information. (See authorities cited *ante*, p. 11.)

For this reason, it is unlikely that malfeasing corporate insiders would consult counsel at all: few, if any, forms of insider fraud are unintentional or innocent (*e.g.*, diversion and hiding of assets, insider trading, looting schemes). Thus trustees are unlikely to find the smoking gun through the attorney, and if some rare instances prove the exception, there is no need to invade (or "waive") the attorney-client privilege.³⁰

As to corporate counsel, it is more likely that any information he has concerning insider fraud stems from discussions with well-intentioned corporate personnel who are "whistle-blowing" or seeking the attorney's aid to discover, cure, or prevent legal problems, including insider malfeasance. These types of confidential attorney-client discussions are the very types of communications which

³⁰ Predictably, if the Court were to uphold bankruptcy trustee waiver power, corporate insiders with illicit plans would shun corporate counsel even more than under current law, particularly during times when insolvency seems possible. Moreover, to the extent that *privileged* knowledge of insider fraud is disclosed after the fact, it is likely to be personal defense counsel, not corporate counsel, who receive such confidences—and such disclosures would be unaffected by the decision of this case as to the *corporation's* privilege. Thus in all but rare instances, a waiver of the corporate privilege is an unpromising means to the ends sought by the Government.

the privilege is designed to promote. (*Upjohn Co. v. United States, supra.*) Occasional admissions of illegal conduct by the perpetrators of corporate misconduct are most likely to occur as the *result* of an internal investigation (as in *Upjohn*) or in preparation of a defense against charges already made. These circumstances, too, require the privilege to be protected.

As this case itself points out, the availability to the trustee of pre-bankruptcy attorney-client confidences is not a matter of necessity at all: it is a matter of *convenience*, time-saving and cost-avoidance. This is conceded by none other than the trustee himself. (Trustee's Pet. Amicus Br., 3.) Thus does the Government's claim of "necessity" collapse. Permitting trustees to invade and waive privilege would sacrifice the confidentiality of attorney-client communications on the altar of efficiency, not need. That argument is surely foreclosed by the policies which have given rise to the privilege in the first instance.

Two final points should be recognized in connection with the Government's effort to justify disclosure of privileged confidences in order to uncover insider fraud:

(1) if such justification is at all persuasive, that reason applies equally to *individual* debtors as it does to corporations (insider fraud is not unique to corporations); and

(2) the disclosure sought here by the Government (both to the trustee and to itself) is much *broader* and *mischievous* than the anti-fraud justification.

Just as insiders (officers, directors, and key management of technical employees) can defraud their corpora-

tion, so can the owners, employees and other "insiders"³¹ of unincorporated enterprises do the same to their businesses (excepting insider trading of stock and possibly a few other devices). Fraud is not precluded by the form of business organization. Sole proprietorships (including individual investors), trusts and partnerships, engage in a wide variety of enterprises and frequently operate substantial, complex businesses. Like corporations, they regularly employ people to operate the business or to manage their affairs. They may even engage in businesses which impose fiduciary obligations to their customers (*e.g.*, brokerages, insurance agencies, real estate firms).

In any of these non-corporate forms, one can have insider fraud, particularly when bankruptcy looms: diversion of assets, preferential dealings, hiding of assets or secreting of funds out of the country or into the hands of friends or relatives. (*See, e.g., Goldstein v. United States*, 11 F.2d 593 (5th Cir. 1926), for one classic example.) The individual who anticipates bankruptcy because of unexpected investment or business reversals, or an act of God (or negligence) which generates uninsured losses or liabilities, can defraud his bankruptcy estate (creditors) just as a corporate insider can defraud the corporate estate. Such people have at least as great an incentive to do so as corporate insiders.

If anti-fraud considerations justify "passing" the attorney-client privilege to a corporation's trustee, then the same result is similarly justified for non-corporate debt-

³¹ The Bankruptcy Code defines "insider" with respect to individuals and partnerships, as well as for corporations, for purposes of certain disqualifications (11 U.S.C. §101(25)).

ors. Like the Government's proffered legal theory, its policy justification for granting bankruptcy trustees control of their debtors' privilege applies across the board and would require the same disposition of individual's privilege(s).

Moreover, the rule advocated by the Government would yield an overly-broad and unwarranted disclosure of attorney-client confidences in two regards: (i) by opening the door to unlimited invasions of the privilege,³² and (ii) by permitting (and arguable requiring) disclosures to others, such as creditors and those would-be creditors who desire to discover or press a claim by means of disclosure of attorney-client confidences, as well as to governmental authorities.

IV. Bankruptcy Trustee Waivers of Debtors' Attorney-Client Privileges Would Be Against Sound Policy

A. The Chilling Effect on Attorney-Client Communications

The prospect of counsel becoming a witness, and disclosing details of confidential discussions to government authorities and creditors, will predictably inhibit clients (and their agents) from freely confiding in counsel. The Government seeks judicial approval for bankruptcy trustees to compel their debtors' former attorneys to make such disclosures by the "waiver" device. The Seventh Circuit took the position:

³² The "waiver" given in this case, if effective, would apply to "any communication or information occurring or arising on or before October 27, 1980" (J.A. 49), which encompasses the entire pre-bankruptcy life of the debtor.

... we reject the [waiver] argument because of its potential chilling effect on attorney-client communications. If the trustee in bankruptcy is permitted to waive the corporate debtor's privilege, the trust inherent in the attorney-client relationship will be jeopardized. Corporate clients will be wary of communicating fully with their attorneys for fear that sensitive information could subsequently be disclosed due to bankruptcy. Free interchange between attorney and client is the cornerstone of effective legal representation.

722 F.2d at 343; *see* Pet. App. 10a-11a

Such "free interchange" cannot exist in the absence of certainty of confidentiality:

But if the purpose of the privilege is to be served, the attorney and client must be able to predict with some degree of certainty whether particular discussions will be protected. An uncertain privilege ... is little better than no privilege at all.

Upjohn Co. v. United States, 449 U.S. 383, at 393 (1981);

see also, 449 U.S. at 402 (Burger, J., concurring).

The kind of retroactive impairment of privilege advocated here, at the discretion of a bankruptcy trustee, would impart just such uncertainty. And its effect would be most felt when insolvency looms.³³ Withholding of in-

³³ See, Note, *Bankruptcy/Waiver of Attorney-Client Privilege*, 73 Ill.B.J. 116 (No. 2, Oct. 1984):

On a policy basis, the ... waiver right does not pass to the bankruptcy trustee. During the period immediately preceding the filing of a bankruptcy petition, a debtor needs to be able to discuss freely and fully its situation with an attorney. Only then will the attorney be able to

(Continued on following page)

formation by clients has the effect of preventing the lawyer from rendering sound advice:

[The privilege's] purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. The privilege recognizes that sound legal advice ... serves public ends and that such advice ... depends upon the lawyer being fully informed by the client. As we stated ... in *Trammel v. United States*, 455 US 40, 51, 63 L Ed 2d 186, 100 S Ct 906 (1980): "The lawyer-client privilege rests on the need for the advocate and counselor to know all that relates to the client's reasons for seeking representation if the professional mission is to be carried out." And in *Fisher v. United States*, 425 US 391, 403, 48 L Ed 2d 39, 96 S Ct 1569 (1976), we recognized the purpose of the privilege to be "to encourage clients to make full disclosure to their attorneys."

Upjohn Co. v. United States, 449 U.S. 383, 389

There is no basis for the Government's prediction that *honest* clients and corporate personnel will speak just as freely to corporate counsel if they know that a bankruptcy

(Continued from previous page)

assess adequately the debtor's options and give the best advice. These considerations are precisely why the privilege exists. Any breach of the confidentiality afforded by the privilege would chill the willingness of a client to discuss fully and frankly the client's situation, leading to potentially erroneous or incomplete legal advice. Such a breach would occur if the bankruptcy trustee were given the power to waive the privilege. The result would be that, for financially insecure corporations, the possibility of a bankruptcy would raise fears of disclosure and would limit the willingness of clients to discuss their legal affairs. When the greatest need for consultation arose within the bankruptcy context, upon the eve of bankruptcy, a client would be in greatest need of legal advice but in greatest fear of what the attorney may later disclose.

trustee may someday compel the lawyer to disclose pre-bankruptcy confidences. Trustee "waivers" would manifestly increase the likelihood of later disclosure, both to government agencies (as this case makes clear and as the Government largely concedes³⁴) and to creditors as well (as the Government implicitly concedes³⁵).

The claim that the chilling effect is no different than the prospect of a change in corporate management (Pet. Br. 30-31) ignores the fact that successor management, however resulting, is elected by the *owners* and is guided by company interests, while bankruptcy trustees are guided by the interests of the estate's *creditors* (reviewed *ante*, pp. 22-26), and their decisions are often quite different.

When corporate management decides to divulge attorney-client confidences or to make the attorney available

³⁴ Bankruptcy trustees are said to regularly cooperate with government investigations (see Pet., 16; Pet. Br., 32). This case demonstrates not only this phenomenon, but the practice of government authorities hand-picking the trustee (or interim trustee) who is unlikely to refuse a "waiver" request (see p. 7 n6, p. 1 n2, *ante*).

³⁵ Any "waiver" decisions by trustees must be determined by the interests of the estate (Pet. Br., 32 n53). In addition, given trustees' duties to the creditors, and the human proclivity to reflect the interests of those who elect them, creditors' requests for waivers of privilege, like the CFTC's here, would hardly ever be refused. Creditors and would-be claimants would have nothing to lose and in many cases much to gain by obtaining the lawyer's testimony on confidential communications which might (even speculatively) aid them in establishing or enlarging their claims (e.g., in cases of dubious liability, and especially where corporate punitive damages are sought on *respondeat superior* grounds, see, Restatement (Second) of Agency, § 217C (1958); *Mattyasovszky v. West Towns Bus Co.*, 61 Ill. 2d 31, 36-37, 330 N.E.2d 509, 512 (1975). Creditors' lawyers would routinely seek waivers to discover privileged communications. Pre-bankruptcy confidences would often, if not always, be subject to disclosure.

as a witness, it does so to obtain a *quid pro quo* for the company. As this case so well demonstrates, the cost-benefit equation is fundamentally altered when a bankruptcy trustee is in control. Thus the fact that it may *sometimes* be in the company interest to waive (Pet. Br., 30 n51) is simply not a basis for assuming that that is the normal case. The Government understandably focuses on the few instances where management is entirely dishonest, and acts against the company interest. That, however, is not a reason to sacrifice attorney-client confidentiality for all corporations (or all people) upon bankruptcy. And that is the necessary impact of a trustee waiver power, since trustees (and prosecutors) will seek attorney-client disclosures whenever they *suspect* insider misconduct or even mismanagement.

A trustee waiver power will especially chill the willingness and ability of honest managers to utilize their counsel to perform in-house investigations. (That was exactly the situation in *Upjohn*, *supra*.) The investigatory function of legal counsel, who is clothed with the aura of confidentiality like none others in the corporate structure, to obtain disclosure from company staff, will be destroyed by the knowledge that if the company fails to avoid insolvency, management assurances of confidentiality may give way to a trustee's "cooperation" with government investigators.³⁶

³⁶ Many companies prefer in-house resolution of problems even where prosecution or civil action if feasible, because public disclosure of their failure to prevent the problem can devastate customer (or financiers') confidence. The likelihood of post-bankruptcy violation of pre-bankruptcy assurances of secrecy would inhibit if not prevent companies from effecting their own solutions to their own internal problems.

The foreknowledge that a corporation's attorney-client privilege may be waived someday in the interests of its creditors would inhibit pre-bankruptcy disclosures by corporate personnel to corporate counsel.

B. A Trustee Waiver Power Would Discriminate Against Insolvent Clients

The Seventh Circuit found below:

. . . allowing the trustee in bankruptcy to waive the attorney-client privilege of the corporate debtor discriminates against the corporate debtor solely on the basis of economic status. A solvent corporation, as long as it remains solvent, can freely assert or waive its attorney-client privilege. * * * . . . [I]nvestigating the affairs of the corporate debtor on behalf of the creditors . . . does not justify erosion of the corporation's attorney-client privilege simply on the basis of a change in economic circumstances.

722 F.2d at 343; Pet. App. 10a

The Government calls this concern "groundless" (Pet. Br. 32). But the underlying purposes of the attorney-client privilege do not concern the financial condition of the client. However justified, economic discrimination is precisely the effect if a trustee, whose authority arises only upon bankruptcy, can waive privilege without the consent of the privileged party, as the trustee in this case has attempted to do, at the Government's request (as trustees usually do (Pet., 16)). The net result is that the attorney becomes an available government witness as to his client's private confidences which, but for bankruptcy, he would not be.

C. Distortion of the Bankruptcy Laws' Purpose and Impact

If the consequences of bankruptcy, voluntary or involuntary, include allowing trustees to "waive" privilege as

to prior confidential communications of their debtors, then a new set of incentives and disincentives for bankruptcy will have been created. If this Court upholds trustee waivers, the prospective disclosure of pre-bankruptcy confidences will become a disincentive for invoking the protections of bankruptcy (for debtors) and an incentive for filing involuntary proceedings (by creditors). Neither result comports with the purposes of the bankruptcy laws.

Injection of such considerations into bankruptcy would skew the application of the bankruptcy laws in a manner not contemplated by Congress. The availability of privileged evidence to creditors—evidence unobtainable outside of bankruptcy—also runs afoul of this Court's concerns in *Butner v. United States*, 440 U.S. 48 (1979).

At least two applications of the proposed trustee waiver power, and concomitant availability of privileged evidence to creditors, implicate *Butner*. First, some creditors and prospective claimants against the debtor could obtain a better position as against the debtor (equity owners or shareholders) than they had before bankruptcy.³⁷ Second, those who improve their claims over the pre-bankruptcy legal environment reduce the distributions to other outside creditors who are not equally benefitted by the availability of previously privileged evidence.

The Court's refusal in *Butner, supra*, to countenance a different result as between creditors, because of the

³⁷ This is especially true where disclosed confidences enable the claimant to establish punitive damages (see, 11 U.S.C. §726 (a)(4)). It would also occur where a claimant obtained evidence through bankruptcy disclosure of privileged information that enabled him to establish what was otherwise an unproveable liability outside of bankruptcy.

happenstance of bankruptcy, focused on state property laws. Yet the same result of differential impact on creditor-creditor recovery would be *created* by the proposed trustee waiver power. This differential, arising from the availability of privileged evidence, would be as dispositive of the result in many cases as refusing to apply state property law in bankruptcy.

The Government's effort to invoke *Butner, supra*, in support of its position (Pet. Br., 23 n40) is based on a presumed bankruptcy *incentive* for debtors to file bankruptcy so that *dishonest* management can retain control of privilege. That argument has no application to honest management, and further ignores the points that (i) corporate directors can be replaced by the stockholders (and officers by directors) after as well as before bankruptcy, and (ii) the stockholders can compel disclosure of privileged communications upon accusations of insider fraud (*Garner v. Walfinbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971)). The Government's position is that creditors should have access in bankruptcy to privileged attorney-client confidences which they may not obtain outside of bankruptcy.

If, as *Butner* suggests, creditors' recovery in bankruptcy should reflect their recovery rights under applicable state law before bankruptcy, then creditors should not gain rights *vis-a-vis* other creditors or over corporate shareholders because of bankruptcy trustee "waivers".

D. The Proposed Trustee Waiver Power Would Apply to Individual Debtors; Selective Application to Avoid this Result Would Be Irrational

As reviewed *ante*, the trustee waiver power urged by the Government necessarily applies to all debtors in bank-

ruptcy, regardless of their form, if it applies at all: the "management" theory as well as the claimed anti-fraud justification admit of no distinctions between debtor status.³⁸ But the uniform application of this power to individual debtors³⁹ would plainly be too great a price to pay for the proposed anti-fraud tool, which is no cure in any event.

If this Court were somehow to allow trustee waivers only for corporate bankruptcies while preserving privilege for non-corporate debtors,⁴⁰ or even were somehow to limit such waivers solely to corporations, the result would be an irrational distortion of the bankruptcy system.

In either event, identical businesses would be subject to materially different treatment in bankruptcy due to their incorporated or unincorporated status. Closely-held

³⁸ See, Point II(c), pp. 26-30, *ante* (theory); Point III, pp. 35-37, *ante* (justification).

³⁹ Courts that have confronted bankruptcy trustee waivers of individual debtors' privilege have generally allowed such waivers. (*In re Smith, supra*; *In re Grand Jury Proceedings, supra*). One court that rejected a waiver attempt for an individual, but not for a corporation, did so out of shock at the potential consequences, but offered no cogent legal basis for distinguishing individual debtors. *In re Silvio De Lindegg Ocean Developments of America, Inc.*, 27 B.R. 28 (Bankr. S.D. Fla. 1982).

⁴⁰ In light of *Bellis v. United States*, 417 U.S. 85 (1974) (partnership has independent institutional identity from individual partners for purposes of the Fifth Amendment privilege) and the cases reviewed in *Bellis*, it seems clear that if corporations' privileges pass to the trustee, then partnerships' privileges would also pass. Cf., *In re Boileau*, 736 F.2d 503 (9th Cir. 1984). Presumably trusts, as separate entities, would suffer the same result. Cf., *In re Continental Mortgage Investors*, No. 76-593-S (D.Mass. July 31, 1979) (unpublished) (Massachusetts business trust).

enterprises, family businesses, and sole proprietorships, which are often indistinguishable excepting technical legal status, would either retain or lose their attorney-client privilege to an outside trustee depending on whether they had incorporated. In these circumstances, the result would turn on what is patently a legal fiction. The difference in treatment would bear no rational relation to any real distinction, and certainly not to (i) economic differences or bankruptcy policy, (ii) differences in the attorney-client relationship or the purpose of the privilege, or (iii) the likelihood of insider fraud.

Finally, the creation of a trustee waiver power would create remarkably different treatment amongst different bankruptcy proceedings, as there could be no trustee waiver in those cases where the debtor avoids having a trustee appointed. (*See*, 11 U.S.C. §§ 1104, 1107.) Of course, the Government and the U.S. Trustee would seek a trustee whenever they desire to invade privileged attorney-client confidence of the debtor, which may (or may not) be only those few cases where they suspect insider fraud.

The Government's arguments focus exclusively on corporate bankruptcies involving insider fraud. Because the trustee waiver power urged by the Government cannot be restricted to instances of insider fraud (and would be senseless if it could), it is submitted that the considerations advanced by Respondents strongly outweigh those urged by the Government. In 1982, for example, there were over 77,000 "business" bankruptcies reported. (*See*, U.S. Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States 1984*, p. 536 (104th Ed.)) The possibility of insider fraud in some, and the

chimerical benefits predicted by the Government for those few, cannot outweigh the adverse effect of such a rule on the remainder.

This too would be "too great a wrench . . . to give the bankruptcy system, absent a plain indication from Congress which is lacking here." *Lewis v. Manufacturers National Bank*, 364 U.S. 603, 610 (1961).

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be affirmed.

January, 1985

Respectfully submitted,

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